

ORDER NO. 4227

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Chairman;  
Mark Acton, Vice Chairman;  
Tony Hammond;  
and Nanci E. Langley

Periodic Reporting  
(Proposal Seven)

Docket No. RM2017-11

ORDER ON ANALYTICAL PRINCIPLES  
USED IN PERIODIC REPORTING (PROPOSAL SEVEN)

(Issued November 20, 2017)

I. INTRODUCTION

On July 28, 2017, the Postal Service filed a petition pursuant to 39 C.F.R. § 3050.11 requesting that the Commission initiate an informal rulemaking proceeding to consider a change to an analytical principle relating to periodic reports.<sup>1</sup> A discussion of Proposal Seven is attached to the Petition. Proposal Seven would modify the analytical principle relating to the calculation of certain dropship passthroughs for USPS Marketing Mail. In particular, the Postal Service proposes to include both the piece-rated and pound-rated discount in its dropship passthrough calculation for flats and parcels. Petition, Proposal Seven at 2.

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<sup>1</sup> Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Seven), July 28, 2017 (Petition).

## II. PROCEDURAL HISTORY

On August 1, 2017, the Commission issued Order No. 4024, establishing the instant docket to consider the Petition, designating a Public Representative to represent the interests of the general public, and establishing a deadline for filing comments.<sup>2</sup>

Chairman's Information Request No.1 (CHIR No. 1) was issued on August 22, 2017.<sup>3</sup> On August 29, 2017, the Postal Service responded to CHIR No. 1.<sup>4</sup> Chairman's Information Request No. 2 was issued on September 11, 2017, to which the Postal Service responded the next day.<sup>5</sup>

The Association for Postal Commerce (Postcom) and the Public Representative filed comments on September 15, 2017.<sup>6</sup> The Public Representative later filed corrected comments on September 20, 2017, along with a motion for leave to file her corrected comments and workpapers.<sup>7</sup> The Postal Service filed reply comments on September 22, 2017, together with a motion for leave to reply.<sup>8</sup>

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<sup>2</sup> Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Seven), August 1, 2017 (Order No. 4024).

<sup>3</sup> Chairman's Information Request No. 1, August 22, 2017 (CHIR No. 1).

<sup>4</sup> Responses of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 1, August 29, 2017 (Response to CHIR No. 1).

<sup>5</sup> Chairman's Information Request No. 2, September 11, 2017 (CHIR No. 2); Responses of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 2, September 12, 2017 (Response to CHIR No. 2).

<sup>6</sup> Comments of the Association for Postal Commerce, September 15, 2017 (Postcom Comments); Public Representative Comments on Proposed Changes in Analytical Principles (Proposal Seven), September 15, 2017.

<sup>7</sup> Public Representative Motion for Leave to File Corrected Comments and Workpapers, September 20, 2017 (PR Motion); Public Representative Comments on Proposed Changes in Analytical Principles (Proposal Seven) – Corrected, September 20, 2017 (PR Comments). The PR Motion is granted.

<sup>8</sup> Motion of the United States Postal Service for Leave to File Reply Comments Regarding Proposal Seven, September 22, 2017 (Postal Service Motion); Reply Comments of the United States Postal Service Regarding Proposal Seven, September 22, 2017 (Postal Service Reply Comments). The Postal Service Motion is granted.

### III. BACKGROUND

The Postal Service reports USPS Marketing Mail dropship passthroughs for rate categories in the Annual Compliance Report (ACR). Passthroughs are the ratio of workshare discounts to their respective avoided costs. Dropship discounts are a type of workshare discount offered to mailers for entering mail at a processing facility closer to the final destination.

In USPS Marketing Mail, there are two groups of rates available to mailers: piece rates below the breakpoint and piece and pound rates above the breakpoint.<sup>9</sup> Both of these groups of rates have dropship discounts. Each year in its ACR, the Postal Service reports dropship passthroughs for flats and parcels rate categories. These passthroughs are currently calculated with reference to the per-pound rate element above the piece-pound breakpoint. Petition, Proposal Seven at 2. The current passthrough calculation for dropship flats and parcels divide the pound-rated discount for pieces above (*i.e.*, heavier than) the breakpoint by the average pound-rated avoided cost for pieces both above and below the breakpoint. *Id.* This calculation is represented by the following equation:

$$\text{Current Passthrough Calculation} = \frac{\text{Per-pound discount for pieces above breakpoint}}{\text{Avoided cost per pound for all pieces}}$$

### IV. PROPOSAL SEVEN

The Postal Service identifies two shortcomings in the current passthrough calculations for USPS Marketing Mail dropshipped flats and parcels in its proposal. *Id.* at 1. The first shortcoming is that the numerator of the passthrough calculation does not include the piece-rated element below the breakpoint. *Id.* Similarly, the second

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<sup>9</sup> The Postal Service prices mail differently depending on the average weight of the mailing. Below a certain average weight, or breakpoint (3.3 to 4 ounces, depending on the rate category), the Postal Service prices per item; above the breakpoint, the Postal Service prices per item and per pound. See *generally* Mail Classification Schedule section 1200.

shortcoming is that the numerator and denominator of the passthrough calculation are mismatched: the numerator only represents pieces above the breakpoint, while the denominator represents pieces both above and below the breakpoint. *Id.* at 1-2.

To remedy these shortcomings, the Postal Service proposes to calculate the total dropship discount amounts and divide them by the total costs avoided for each entry level. *Id.* at 2. The Postal Service's solution will reflect both price elements that vary by depth of entry (per-pound above the breakpoint and per-piece below the breakpoint) and will treat both the numerator and the denominator as representing all volume, below and above the breakpoint. *Id.* The proposal modifies the numerator in the passthrough calculation to be the pound-rated discount multiplied by the number of pound-rated pounds plus the piece-rated discount multiplied by the number of piece-rated pieces. *Id.* The Postal Service proposes two options for the denominator: either the total avoided cost per piece times the total number of pieces (Alternative 1), or the total avoided cost per pound times the total number of pounds (Alternative 2). *Id.* These two calculations are represented by the following equations:

$$\text{Alternative 1: } \frac{((\text{Pound discount} * \text{Pounds above breakpoint}) + (\text{Piece discount} * \text{Pieces below breakpoint}))}{(\text{Avoided cost per } \textbf{piece} * \textbf{Pieces above and below breakpoint})}$$

$$\text{Alternative 2: } \frac{((\text{Pound discount} * \text{Pounds above breakpoint}) + (\text{Piece discount} * \text{Pieces below breakpoint}))}{(\text{Avoided cost per } \textbf{pound} * \textbf{Pounds above and below breakpoint})}$$

The Postal Service originally opted for Alternative 1. *Id.* In its response to CHIR No. 1, the Postal Service concluded that Alternative 2 is equally acceptable, if not superior to Alternative 1 because the piece-pound conversion factors used in developing avoided costs for Alternative 2 are calculated more granularly at the rate category level. Response to CHIR No. 1, question 2. Conversely, the piece-pound conversion factors used in developing avoided costs for Alternative 1 are calculated at the shape level, rather than the price category level. *Id.* The Postal Service asserts

that this proposal will better ensure that workshare discounts do not exceed avoided costs. Petition, Proposal Seven at 2.

## V. COMMENTS

The Commission received comments from Postcom and the Public Representative. The Commission also received reply comments from the Postal Service.

The Public Representative agrees with the Postal Service that the current methodology is flawed, but proposes that the per-piece discount and per-pound discount be evaluated separately. PR Comments at 2. She argues that each mailer pays either the per-piece price or the per-pound price, but does not pay both for a single mailing. *Id.* She asserts that in choosing whether to workshare, a mailer considers the discount for a particular mailing, not a blended discount of two differently priced mailings (one above the breakpoint and one below the breakpoint). *Id.* at 3. Therefore, the Public Representative proposes separate passthroughs for piece-rated pieces and pound-rated pieces. *Id.* at 5. She also proposes changing the denominator of the passthrough calculation to separate the pound-rated transportation cost and the piece-rated non-transportation cost. *Id.* at 5-6. She asserts that this change more accurately reflects how costs are incurred in worksharing. *Id.* at 9.

Postcom does not object to the acceptance of Proposal Seven, but raises concerns about the Postal Service's representations about the proposal. Postcom Comments at 1. It objects to the Postal Service's characterization of Proposal Seven as improving the accuracy of passthrough representation. *Id.* at 2. Postcom observes that the calculation of avoided costs is more complicated than the Postal Service represents, and that Proposal Seven does little to improve the underlying avoided cost calculation. *Id.* Postcom urges the Commission, if accepting Proposal Seven, to explicitly recognize that section 3622 of title 39 of the United States Code does not absolutely forbid rates with discounts that exceed avoided costs even when the rate level does not fully recover its costs, citing to the exceptions in section 3622(e). *Id.* at 4; see 39 U.S.C.

§ 3622. It also recommends that the Commission clarify that the output of the passthrough formula is not, in and of itself, determinative of compliance or noncompliance with the Act. Petition, Proposal Seven at 5.

In its reply comments, the Postal Service disagrees with the Public Representative's recommendation that passthroughs should be calculated separately for mailings above the breakpoint and mailings below the breakpoint. Postal Service Reply Comments at 5. It observes that the Public Representative assumes a perfectly proportional relationship between cube, the cost driver in transportation, and weight. The Postal Service states that there is no evidence for this assumption. *Id.* at 5-6. In addition, the Postal Service notes that varying parcel densities can have wide-ranging implications for passthrough calculations. *Id.* The Postal Service argues that adding another constraint to the USPS Marketing Mail pricing would create undesirable complications. *Id.* at 7-8. It also asserts that the Public Representative's methodology does not accurately calculate passthroughs for mailings below the breakpoint because their differentiating price element is the number of pieces, while the cost driver is cubic volume. *Id.* at 9-10. Within this range, the Postal Service states that enforcing workshare rules is an exercise in false precision. *Id.* In its reply comments, the Postal Service agrees with Postcom that the further one probes into the particular workshare activity of dropshipping, the greater the awareness that mechanistic rigidity has its limitations. *Id.* at 11-12.

*Commission analysis.* Based upon a review of the Postal Service's filing, supporting workpapers, the comments received, and the responses to CHIRs, the Commission finds that Proposal Seven improves the accuracy and completeness of the calculation of USPS Marketing Mail flats and parcels dropship passthroughs. Specifically, the Commission finds that Alternative 2 is the best approach to calculating USPS Marketing Mail flats and parcels dropship passthroughs.

Adopting Alternative 2 of Proposal Seven will improve the accuracy and completeness of passthroughs reported in the ACR. Currently, the passthrough calculation relies upon a single discount and a single unit avoided cost to calculate the

passthrough. However, for USPS Marketing Mail flats and parcels dropship discounts, there are both per-piece discounts and per-pound discounts. The Commission finds that the Postal Service's proposal to calculate a total discount and total avoided cost for each entry level better reflects the existence of both per-piece discounts and per-pound dropship discounts than the current calculation. The proposal provides a more detailed expression of passthrough discounts that account for quantities of mail both above and below the breakpoint.

The Alternative 2 calculation also improves the accuracy of the passthrough calculation because it allows for a more granular calculation of avoided cost at the rate category level, whereas Alternative 1 is limited by calculations at the more aggregate shape level (e.g., letters and flats). Response to CHIR No. 1, question 2.

The impact of Alternative 2 is to increase dropship passthroughs modestly compared to the passthroughs in the FY 2016 ACR. On average, passthroughs would have increased by 11.5 percentage points.<sup>10</sup> The largest change occurs in Commercial and Nonprofit High Density, High Density Plus, and Saturation Flats dropshipped at DNDC locations where the passthrough would have increased from 53.1 percent to 90.2 percent. *Id.*

The Commission declines to adopt the Public Representative's alternate proposed methodology. The Public Representative's proposal would further complicate USPS Marketing Mail pricing by altering the current smooth transition over the breakpoint.<sup>11</sup> The Commission notes that additional evidence that the relationship between weight and cube are perfectly proportional would be required to support this proposal.

Postcom's concerns about the Postal Service's characterization of the change do not relate to the Commission's acceptance of Proposal Seven. The Commission notes

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<sup>10</sup> Response to CHIR No. 2, Excel file "Prop.7.Dropship\_Pass.CHIR.2.xlsx."

<sup>11</sup> USPS Marketing Mail prices are designed to have a smooth transition across the breakpoint; meaning that the price for a 4-ounce flat would be the same if it was calculated using the per-piece rate or the per-piece and per-pound rate.

that Proposal Seven does not change the framework the Commission uses to determine workshare discount compliance with section 3622(e).

For these reasons, the Commission finds that Alternative 2 within Proposal Seven is the most reasonable proposal to improve the quality of the Postal Service's analysis in two ways: (1) the numerator of the passthrough formula includes the per-piece price element below the breakpoint; and (2) the numerator and denominator appropriately represent volume both above and below the breakpoint. Therefore, the Commission approves Proposal Seven using the Alternative 2 calculation provided in Response to CHIR No. 2.

#### VI. ORDERING PARAGRAPH

*It is ordered:*

For purposes of periodic reporting to the Commission, the changes in analytical principles proposed by the Postal Service in Proposal Seven, using the Alternative 2 calculation provided in Response to CHIR No. 2, are approved.

By the Commission.

Stacy L. Ruble  
Secretary